

DEPARTMENT OF TRANSPORTATION**Federal Transit Administration****Innovative Financing Initiative:
Administrative Policies and
Procedures Facilitating Use of
Innovative Finance Techniques in
Federally-Assisted Transit Project**

AGENCY: Federal Transit Administration, DOT.

ACTION: Notice.

SUMMARY: This Notice describes innovative financing methods and asset management tools which may be used in connection with projects receiving assistance from the Federal Transit Administration (FTA) in order to facilitate financing, leverage Federal, State and local funds, and otherwise increase the effectiveness of transit capital projects.

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SUPPLEMENTARY INFORMATION: The Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA) encourages more efficient management and enhancement of our Nation's public transit infrastructure through the creation of public/private investment partnerships. In addition Executive Order 12893, "Principles for Federal Infrastructure Investments," signed by the President on January 26, 1994, directs each executive department "to ensure efficient management of infrastructure * * *" and "to encourage private sector investment, which is a key objective of our efforts to promote innovative financing." Underlying this guidance is the notion that market-oriented financing and management techniques can be effective tools for meeting our Nation's needs for infrastructure investment. To further these directives, on September 12, 1994, FTA published a Notice regarding its Innovative Financing Initiative in the **Federal Register** (59 FR 46878) in which FTA requested information from its grantees about their use of innovative financing techniques in local transit projects.

This Notice combines in a single document current innovative financing methods and assets management tools and indicates, where appropriate, changes in administrative practice or policy guidance that may facilitate their use. Grantees and others in the transit community may find it useful to have in one publication a summary of the

permissible financing and management techniques under FTA's grant programs. Grantees should, however, refer to the appropriate FTA regulations, circulars, reports, and publications that explain these techniques in greater detail, or contact their FTA Regional Office for further guidance and assistance.

The discussion below is divided into two broad categories, Innovative Finance Techniques and Asset Management Tools.

FTA Innovative Finance Techniques

This section describes innovative financing techniques which may be used in connection with Federal transit assistance. In general, the techniques can be used with new projects financed with the FTA Urbanized Area Formula Program (49 U.S.C. 5307, formerly Section 9 of this Federal Transit Act, as amended) funds, as well as with Title 23, United States Code (e.g., Surface Transportation Program (STP) and Congestion Mitigation and Air Quality program (CMAQ)) funds transferred to be used for transit projects. In most cases, the techniques can also be used with funds from the Capital Program (49 U.S.C. 5309, formerly Section 3), as well as Nonurbanized Area Formula program (49 U.S.C. 5311, formerly Section 18), and Elderly and Persons and Disabilities Program (49 U.S.C. 5310, formerly Section 16) funds. Many of the procedures can also be used with respect to assets previously acquired with Federal transit assistance. For clarity, each technique is described separately. Grantees should take note that two or more techniques may be combined in the same project to generate additional savings or to further enhance private financing.

FTA generally supports use of innovative financing concepts that enhance the effectiveness of public transit investment by either generating increased investment or by reducing overall project costs. The following techniques and provisions of Federal transit laws are illustrative of the types of innovation that FTA will support. The list is not exclusive; grantees interested in pursuing techniques not listed here should contact their FTA Regional Office. FTA will evaluate proposals on a case-by-case basis, and where appropriate make further changes in administrative procedures, or if necessary, revise its rules and regulations to make such changes.

- **Leasing.** FTA funds may be used to lease, rather than purchase, transit equipment and facilities. Urbanized Area Formula Program (49 U.S.C. 5307, formerly Section 9) funds may be used to cover the costs of new an pre-existing

leases, so long as leasing is more cost effective than a direct purchase. FTA regulations at 49 CFR part 639 prescribe how leasing of transit equipment may be eligible. Moreover, FTA permits on a case-by-case basis, using slightly different criteria, such leasing under the Capital Program (49 U.S.C. 5309, formerly Section 3), Nonurbanized Area Formula Program (49 U.S.C. 5311, formerly Section 18), and Elderly and Persons with Disabilities Program (49 U.S.C. 5310, formerly Section 16).

- **Certificates of Participation (COPs).** Certificates of Participation (COPs) are a type of leasing arrangement in which bonds are issued to finance the purchase of transit assets. Typically, the public transit agency (lessee) enters into a lease with a trustee or non-profit entity (lessor) for the assets it wishes to acquire. The lessor then transfers its rights to receive the lease payments made by the transit agency to the bond holders. The cash paid by the bond holders is used to purchase the assets that will be leased by the transit agency. The transit agency makes lease payments from local revenue sources and FTA grants. Title to the assets is held by the trustee for the security interest of the bond holders during the life of the transaction (usually 7 to 12 years). Use of this technique may allow transit agencies to use future reserves of local and federal revenues to accelerate equipment purchases. Although historically FTA recipients have engaged in COPs transactions solely for the purchase of vehicles, this technique may also be used to acquire facilities. Approximately six of these have taken place with federally funded equipment. Further guidance on the use of COPs can be found in FTA Report No. FTA-MA-90-7005-93-1 ("How to Evaluate Opportunities for Cross Border Leasing and COPs," November 1993).

- **Joint Development.** Under 49 U.S.C. 5309(a)(5) and (f) and 49 U.S.C. 5309(a)(7) (formerly Sections 3(a)(1)(D) and 3(a)(1)(F)), Capital Program funds can be used for a variety of joint development activities, so long as they are physically or functionally related to a transit project and they enhance the effectiveness of the transit project. Further, consistent with the additional flexibility in funding and decisionmaking afforded by ISTEA, FTA has recently interpreted the Capital Program (49 U.S.C. 5309) and the Federal Transit laws (49 U.S.C. 5301 *et seq.*) to allow such joint development projects under the Urbanized Area Formula Program (49 U.S.C. 5307, formerly Section 9), as well as the STP (23 U.S.C. 133) and the CMAQ Program (23 U.S.C. 149) when these funds are

transferred to FTA for a transit project. Similarly, by this Notice, FTA is also alerting its grantees to the fact that assets previously acquired with FTA funds may be used for such joint development purposes. For example, land now used for station parking and no longer needed for transit purposes may be converted to use in a transit-related development project.

Certain cross-cutting Federal requirements will apply to the activities supported by Federal transit funds; however, such requirements would not apply to the commercial project itself, since Federal funds cannot be used for the construction of commercial revenue-producing facilities. FTA program funds may be used for the overall planning of a transit project, including the commercial revenue-producing facilities, so long as such commercial facilities are part of an overall transit-related project.

- *Use of Proceeds from Sale of Assets in Joint Development Projects.* To facilitate joint development activities, FTA permits the sale of real property and property rights acquired with FTA assistance, in the following instances.

Real property that is no longer needed for transit purposes may be sold and the proceeds may then be used to purchase other real property for a transit-supportive development. If the real property is leased, the proceeds are considered program income and may be used for any transit purpose.

- Air rights over transit facilities constructed with Federal funds may be sold to developers and the proceeds retained as program income for future use in mass transit, rather than returned to the Treasury.

- *Cross Border Leases.* A cross border lease is a mechanism which permits investors in a foreign country to own assets in the United States, lease them to an American entity, and receive tax benefits under the laws of their own country. FTA will permit the encumbrance of federally funded assets under a cross border lease so long as the grantee maintains continuing control and use of the asset in mass transit, and the benefits of the transaction outweigh the risks to the grantee. Grantees should provide FTA with the details of the transaction for review on a case-by-case basis. FTA's policy on Cross Border Leases is contained in FTA Circular 7020.1 ("Cross Border Leasing Guidelines"). Further guidance on cross border leases is available in FTA Report No. FTA-MA-90-7005-93-1, cited previously.

- *Capital Cost of Contracting.* FTA permits grantees to count a portion of the costs of a contract with a private

operator for transit service operations as a capital cost eligible for FTA capital program funding. This policy is described in more detail in FTA Circular 7010.1 ("Capital Cost of Contracting"). This policy generally applies to contracting for providing transit services where the use of facilities and equipment is provided as a part of a transit service contract.

- *Innovative Procurement Approaches.* FTA encourages grantees to use a wide variety of innovative procurement techniques. These can include multi-year rolling stock procurements, forming consortia to facilitate efficiencies of scale in rolling stock procurements, or using design-build ("turnkey") as a method of infrastructure project delivery. Grantees can also consider use of vendor-financing in procurements, such as "super-turnkey," in which the contract calls for borrowing by the design-build contractor, with the costs, including interest, paid off over time using Federal grant funds. Further information on this form of procurement is available in FTA Report No. FTA-MA-08-7001-92-1, "Turnkey Procurement: Opportunities and Issues."

- *State Transit Finance Support.* FTA encourages States and local governments to develop the capability to provide support for transit finance initiatives. Where State law permits, FTA capital funds can be used to support transit-related State finance entities, such as transportation banks. Such finance entities could provide a range of financing options, including cross border leases, certificates of participation, joint procurements, and the like, that may not otherwise be available to the smaller transit agencies. While FTA capital program funds can be used to cover the initial capitalization, they cannot be used to cover the ongoing operating costs of such a program.

- *Revolving Loan Funds.* By this Notice, FTA announces that Federal grant funds may be used to support State or local revolving loan funds established in accordance with appropriate State laws. These funds would be available to provide direct loans for transit projects, or to acquire equipment and facilities and lease them to providers of public transportation in their States. Payments to retire the loans or service the leases, including accrued interest, would be used to fund other transit projects. Such a revolving loan fund could be used in combination with pooled procurements, State or locally issued bonds, joint development, and other techniques to generate income for transit investment or to reduce the

overall cost of transit capital investment. As with the State Transit Finance entities, FTA funds can be used to cover the initial capitalization, but they cannot be used to cover the ongoing operating costs of such a program.

- *Deferred Local Match.* FTA permits grantees to defer the payment of the local share of transit projects. Under this policy, grantees may, with prior approval from FTA, draw down 100 percent of the first 80 percent of project cost of former section 3 (49 U.S.C. 5309), 8 (49 U.S.C. 5303), 9 (49 U.S.C. 5307), 16 (49 U.S.C. 5310), 18 (49 U.S.C. 5311) and 26 (49 U.S.C. 5320) projects, covering the local share of the costs at the end of the project. See, "Policy Statement on Local Share Issues," 57 FR 30880, July 10, 1992.

- *Transfer of Federal Interest.* In order to facilitate the implementation of certain innovative financing transactions involving the lease or encumbrance of an asset, FTA will permit the concentration of the Federal interest in a portion of assets acquired with Federal funds, leaving the remaining portion unencumbered by any Federal interest. For example, where a fleet of 100 vehicles is acquired with Federal funds with a local share of 20 percent, the Federal interest may be concentrated in 80 of those vehicles, leaving the remaining 20—the local share—of the vehicles without any Federal interest. Moreover, this separation of Federal and local interests allows the grantee to explore other financing techniques, such as using the local share for COPs or cross border leases to leverage additional funds, or using short-term lending, or debt subordination, where arbitrage issues could be involved. For example, the portion of a fleet or facility without Federal interest could be mortgaged, and the proceeds used to earn interest or act as credit enhancement on a bond issue supporting a major investment, thus generating savings for the transit authority.

- *Like Kind Exchange.* FTA permits the transfer of the remaining Federal interest in an asset to be transferred to a new asset in order to facilitate the early replacement of such assets. For example, under the FTA Like Kind Exchange policy (described in more detail in 57 FR 39328, August 28, 1992), buses which have reached only one-half their expected useful life may be sold and the proceeds may be used to pay part of the cost of like-kind replacement vehicles, so long as the remaining Federal interest in the vehicles which are sold is applied to the new vehicles. In such cases, the proceeds of the sale

of the vehicles does not have to be returned to the Federal government.

- *Incidental Non-Transit Use.* FTA-funded facilities may also be used for limited non-transit purposes. For example, FTA funds may be used for acquisition of a Compressed Natural Gas fueling facility which will be used both by the transit operator's vehicles as well as other public vehicles. In such a case, FTA will participate in the capital costs of the facility proportionate to the needs for transit operations, including any designed-in reserve capacity necessary to assure reliable transit service. However, non-transit use should be incidental, i.e., not detract from or interfere with the mass transit use of the facility. FTA will determine what use is incidental on a case-by-case basis. It should be noted that 49 CFR parts 604 and 605 prohibit the use of FTA-funded facilities for charter and schoolbus purposes.

FTA Asset Management Tools

- *Transfer of Federally-Assisted Assets.* 49 U.S.C. 5334(g) allows existing, federally supported assets to be transferred for another public use when they are no longer required for transit purposes. For example, if a bus garage is no longer needed for transit purposes, it may be transferred to local municipal ownership for use in support of general public services. This new provision may also have application in support of innovative financing techniques, for example, by permitting transfer of ownership of assets acquired with Federal funds to local public use in

return for other local support for transit. These transfers are subject to very specific statutory conditions and must be approved in advance in writing by FTA.

- *Coordinated Urban and Rural Services.* Assets acquired with FTA funds may be used for any purpose which is eligible for FTA funding. Thus, assets acquired with Urbanized Formula Program funds (49 U.S.C. 5307, formerly Section 9) or Capital Program (49 U.S.C. 5309, formerly Section 3) funds may be used in a rural setting together with assets acquired under the Nonurbanized Area Formula Program (49 U.S.C. 5311, formerly Section 18), as part of a coordinated rural/urban system. Likewise, assets acquired for service in non-urbanized areas can be used in urbanized areas as part of such a coordinated rural/urban system.

- *Corridor Preservation/Advance Right of Way Acquisition.* In limited circumstances, FTA program funds can be used to acquire and preserve existing transportation corridors and rights of way for future use in transit fixed guideway projects, or existing corridors and rights of way acquired with local funds can be used as local match for FTA grants. Indeed, should there be an increase in the market value of an existing corridor or right of way acquired with local funds only before the use of that property for a transit project, the property would be accepted as a local match for an FTA grant at its increased value. Acquisitions of existing corridors and rights of way with FTA funds are subject to two important

constraints: (1) The FTA/Federal Highway Administration (FHWA) requirement for completion of a Major Investment Study before a major investment project can be programmed for construction funding; and (2) the prohibition on advance land acquisition that would prejudice the ultimate decisions on mode and alignment for any transportation project prior to completion of the National Environmental Policy Act (NEPA) studies for that project.

The preceding are example only. FTA welcomes all ideas and projects that have the potential to leverage existing or planned infrastructure investment, or that will help to reduce public transportation costs over time. Grantees interested in pursuing these and other options should refer to the appropriate FTA regulations or publications referenced in this Notice or contact their FTA regional office to discuss their plans in more detail.

FTA will continue to make full use of its regulatory and statutory flexibility in fostering innovative financing proposals for transit. However, in all cases, projects must comply with all other statutory and regulatory requirements such as the NEPA, Civil Rights Acts, Americans with Disabilities Act, the Clean Air Act, and the Administrative Procedures Act.

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Administrator.

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